No. 3617

IN THE

United States
Circuit Court of Appeals

For the Ninth Circuit

H. C. ANDERSON, *Appellant*,

vs.

O. H. AVEY and PAYETTE VALLEY LAND AND ORCHARD COMPANY, Ltd., a Corporation, *Appellees*.

APPELLANT'S PETITION FOR REHEARING

Upon Appeal from the District Court of the United States, District of Idaho, Southern Division

HAWLEY & HAWLEY,
JAMES H. HAWLEY,
JESS HAWLEY,
O. W. WORTHWINE,
SAM S. GRIFFIN,
Residence: Boise, Idaho.
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Comes now the appellant above named, by his counsel of record herein, and respectfully petitions this Honorable Court for a re-hearing herein on the following grounds:

I.

It does not appear from the decision of the Court herein that the Court has given effect to that part of Section 4728, Idaho Compiled Statutes, 1919, reading as follows:

> "No corporation shall issue any stock as paid up in whole or in part, or credit any amount, assessment or call as paid upon any of its stock,

> except for money, property, labor or services actually received by the corporation or actually paid upon the indebtedness of the corporation as provided in this section, to the full value of the amount credited upon such stock."

so far as the same relates to the issuing to Respondent Avey as fully paid 116 shares of stock, each of the par value of $100.00, for $25.00 per share.

II.

The Court erred in holding, in effect, that under Section 4752, Idaho Compiled Statutes, 1919, the Board of Directors might issue and value said 116 shares at $25.00 per share and credit the stock as fully paid, notwithstanding its par value was $100.00 per share and notwithstanding the provisions of Section 4728 of said Compiled Statutes hereinbefore quoted, and notwithstanding that the power to value the thing received in exchange for shares is limited under Section 4752 to "labor done, services performed or property actually received" and not permitted as to money received.

III.

The Court erred in holding, in effect, that the provisions of Section 4752 were applicable to an issue of shares for money.

IV.

The Court erred in holding, in effect, that shares might be issued at less than par value, but credited as issued for full payment.

V.

The Court erred in holding, in effect, that the Board of Directors might under said Section 4752 value the property taken at less than the par value of the stock exchanged therefor, yet credit said shares as fully paid, notwithstanding the provisions of Section 4728, Compiled Statutes, hereinbefore quoted.

VI.

The Court erred in holding that neither the corporation, nor the complainant on behalf of the corporation could maintain this action.

VII.

The Court erred in holding that appellant participated in the transactions.

VIII.

The Court erred in holding that the "bill is absolutely bare of any allegation tending to show any fraud."

IX.

The Court erred in holding that the value of the property transferred for the original stock issued is indicated or shown by the separate purchases of stock made from two to five and one-half years later at one-fourth par value.

X.

The Court erred in holding that the course pursued was sanctioned by the Idaho Statute, either as to the issuance of shares for valueless property, or,

and particularly, as to the issuance of shares as fully paid for one-fourth the par value of such shares.

XI.

The Court erred in affirming the decree of the District Court.

The effect of the decision of this Court is to nullify and render meaningless the provisions of Section 4728, Idaho Compiled Statutes, 1919, reading:

> "No corporation shall issue *any* stock *as paid up in whole* or in part, or credit *any* amount, assessment or sale *as paid* upon *any* of its stock, except *for money, property* * * * actually received by the corporation as provided in this section to the *full* value of the amount credited upon such stock."

because it appears from the decision that a corporation may, apparently, issue shares as fully paid notwithstanding that the par value is $100.00 and the amount actually received in money is but $25.00.

While the Court seems first to consider the correct theory of this action, namely, an action upon a subscription stripped of void agreements relating to the crediting as fully paid stock paid for in part only, yet it abandons this theory and proceeds upon the theory that it is an action to set aside the valuation by the Board of Directors under Section 4752, of property (not money) taken in exchange for stock issued. Under the first theory the Court holds, and correctly,

> "that a corporation has no power to agree with subscribers to its stock upon any terms that are in violation of its articles of incorporation or any constitutional or statutory provision,"

but erroneously holds that there exists in the Idaho statutes no provision against crediting $100.00 as paid upon stock, though but $25.00 is actually received. In other words there is read into Section 4728 an exception which does not exist, i. e., there is excepted thereby, so must be the inference from the opinion, the issuance of stock for money, with the result that so long as stock is issued for *money*, any amount may be credited as paid—a credit binding on the corporation and its innocent, as well as the participating stockholders—whether such *amount of money* is received or not. Such surely is not the true interpretation of such statutory provision; surely it was not intended thereby that the respondent could, as in this case, buy $11,600.00 par value of stock, and be credited, and the corporation and its stockholders held as having received $11,600.00, when, in fact he paid, and the corporation actually received, but $2,900.00.

Either the Court has so held, or it has overlooked that transaction, wholly separate from the transaction for the sale of stock for property, and occurring from two to five and one-half years thereafter. The Court evidently overlooked the fact that the bill sets up two entirely distinct transactions of which complaint is made, (1) the sale of 100 shares in exchange for valueless property and (2) the sale of

116 shares, years later, in exchange for money in value one-fourth that of the par value of the stock; and has applied to the second sale, rules and statutes applicable solely to the first, namely, that the Board of Directors may under Section 4752 value such $25.00 at $100.00 (since, having issued the shares as fully paid the valuation must have been equal to par—the amount credited as having been actually received under Section 4728) and such valuation cannot be impeached except by showing actual fraud in arriving thereat. The bare statement sufficiently argues the inapplicability of said Section 4752, which applies solely to the valuation of labor, services or property other than money, to such a state of facts. It follows that whatever the Court might conclude as to the sufficiency of the showing of fraud with respect to the valuation of the property taken in the first sale, could not be conclusive with respect to the sale for money, which requires separate consideration not shown by the opinion to have been given.

Section 4728 was enacted for some purpose, and with intent that it be applicable to common as well as preferred stock—it appears to be clear, definite and unambiguous; it is not modified or nullified by Section 4752, except that in arriving at the amount to be credited the valuation by the Board of Directors of labor, services or property (other than money, of which there can necessarily be no determination of value) actually received is conclusive in the absence of fraud, yet the opinion compels the conclusion either that the Court considers said Section 4728

without effect and that said Section does not prevent the acknowledgment of receipt of par though not in fact received, nor constitute any limitation on the issuance of common stock, and that the Board might value money at a value different from its face value.

We think it true that under such section, and specifically under Section 4729, the corporation may issue shares of common stock prior to full payment, but it cannot issue such shares as fully paid, nor credit the purchase with full payment *unless and until the payment of the full par value is actually received by the corporation in money, labor, services or property.*

The case of Cunningham v. Holley, Mason, Marks & Co., et al., 121 Fed. 720, cited in the Court's opinion does not throw light upon the application of Section 4728, since it did not involve a similar statute, but is cited by the Court apparently on the matter of the conclusiveness of the valuation of the property involved in the first transaction, and particularly the right of a participating stockholder to question such valuations. It is not in point in this action for the reason that it nowhere appears herein that the appellant participated or acquiesced in, or had any knowledge of, the disposal of the stock concerning which complaint is made. In that case the Court refers to the complainant as "one of the incorporators *who participated in such agreement* * * *." "*A party to such agreement, cannot,* as against other stockholders *with whom he agreed and contracted.*" Such the appellant was not, and to so hold is beyond

the bounds of proper inference (Feehan v. Kendrick, 32 Idaho 224, 179 Pac. 507) and in direct contradiction of the specific allegation of the bill wherein it is alleged that the sales were "without the knowledge and consent of plaintiff" (Paragraph VIII of Bill; Record, pp. 10, 11, 12) and even if appellant could not question the valuation of the property by the Board of Directors without a showing of actual fraud and no such showing appears in the bill, yet neither such decision, or such state of facts, would prevent an action by him on behalf of the corporation to recover unpaid balances of the subscriptions for 116 shares of the stock sold at $25.00 each in money where, necessarily, no valuation of the money was or could have been, made by the Board.

As to the latter the rule announced by the opening paragraph of the opinion, that

> "It is, of course, clear that a corporation has no power to agree with subscribers to its stock upon any terms that are in violation of its articles of incorporation or of any constitutional or statutory provision,"

is applicable, and the corporation may sue for the balance of the par value of the stock issued as on a full subscription stripped of the agreement to receive less than par.

> "* * * the special terms are as a general rule void, * * * *as against the corporation itself* and they cannot be set up * * * to defeat an action *upon the subscription.* * * * This principle has frequently been applied to

special agreements by which subscriptions are to be paid in part only * * * where the * * * general statutory * * * provisions require payment in full * * *."

"* * * In such a case, however, the subscription is not void. The fraudulent and *unauthorized* stipulations are void and *the subscriber is liable upon his subscription as if no such stipulation had been inserted.* * * * The subscription may be enforced by the corporation * * * as if no such agreement had been made."

Fletcher Cyclopedia of Corporations, Vol. 2, pp. 1315-1316,1324-1329.

Appellant's Reply Brief, pp. 8, 9.

But there is sufficient allegation of fraud in the valuation of the property by the Board of Directors, and the Court is in error, we contend, in holding that "the bill is absolutely bare of any allegation tending to show any froud on the part of the appellee Avey, or on the part of any of the other directors of the company." The bill avers:

"Said option or interest was not of the value of said shares of stock so issued, to-wit, $70,000.00 or any value at all to said corporation * * * there was no real or valuable consideration for the issuance of said 700 shares of stock in said defendant corporation, and that no part of the face or par value of said stock has ever been paid, *of all of which said directors had knowledge.*"

And it also appears from the bill that such shares were issued by the directors *to themselves.* (Record, pp. 10, 11, 12; Bill, paragraph VIII.) True the word "fraud" is not used, but in the light of such allegation and of Section 4728, requiring a credit of only the amount actually received, and the admission of non-value contained in appellee's answer, which may be considered in this proceeding in aid of the bill (see Appellant's Reply Brief, pp. 5-7) and the rule that

> "Gross or intentional over-valuation is in itself proof of fraud."
>
> Clinton Min. etc. Co. v. Jameson, 256 Fed. 577; 580 and cases cited.
>
> 14 Corpus Juris, section 1489, p. 963, Section 648, pp. 459-469.

it was unnecessary to use such word, since the facts showing gross and intentional overvaluation upon proof of which a finding of fraud follows, are alleged.

> 21 Cyc. 396.

The Court, however, holds the allegation that the option was of no value to be unfounded because, the Court says, there is an express allegation in the bill "that the same directors paid in cash one-fourth of the par value of 662 of the shares of the stock of the company, obviously for a working capital." We frankly confess that we are unable to follow the court's reasoning. The 662 shares of stock were purchased over a period of three and one-half years,

the first purchase being made over two years after the purchase in which the option was exchanged for stock, and these 662 shares were themselves sold and purchased in violation of Section 4728 as hereinbefore set out. How is it possible to say that the consideration given in entirely separate transactions for shares not involved in or connected with the property transfer, save that they were shares in the same corporation and purchased by the same persons, indicates the value of the property transferred two to five and one-half years previously? How can the $25.00 per share paid in 1915 for the share, for instance, numbered 1000, be held to indicate the value transferred in 1910 for share numbered 1?

Perhaps, and this is the only basis for the holding that we can conceive, the Court deemed the 662 shares to be worth $25.00 per share by reason of the value of the property secured in the previous transaction and infers that the property not only was of the value of $70,000.00, the par value of the stock for which it was given, but of sufficient additional value to constitute assets upon which to issue additional shares with a value of their own; yet this cannot be, for the Court holds that the $25.00 per share was paid in as "working capital," and as such would have no value, necessarily, by reason of other assets. And how, from anything that appears in the record, could the court determine that such property gave value to the later shares, or the consideration for the later shares gave value to the property? It might be that the corporation had, meanwhile, acquired

other properties or assets, or contemplated other activities which gave value to the later shares, or other motives or designs, as numerous as the mind can conceive, impelled the purchase by these directors. Is it to be the conclusion of this Court that one who procures an overvaluation of the property which he conveys to a corporation for its stock, can escape liability for the difference between the true value and the par value of the stock for which he thus subscribes, merely by later purchases for less than par of stock of the same corporation credited as fully paid? And that such act will be deemed proof of proper and adequate valuation of the property first conveyed? We do not believe such to be the law, nor that this Court will retain its position upon a reconsideration of this cause.

It is doubtless true that the course of issuing stock without full payment obtains in all parts of the country, as the Court says, and that the decisions of Courts sanction such practice *where there are no statutory, or other binding, prohibitions.* And so it may be issued in Idaho, under Idaho statute, *but not as fully paid stock* since under Idaho statute the obligation of the subscriber to pay the balance of the par value remains subject to enforcement whenever, as in this case, the necessity arises.

Section 4728, 4729, 4733, 4751, Compiled Statutes, 1919.

Fletcher Cyclopedia of Corporations, Vol. 2, p. 1468.

The cases cited by the Court at conclusion of its opinion are not in point in this action. That of Old Dominion Copper Company vs. Lewisohn, 210 U. S. 206, 212, called for the application of no provision of law such as is found in the Idaho statutes (Sec. 4728) and it further appears that all stockholders were fully advised of the transaction. It is to be noted that the Court in that case observes,

> "If there had been innocent members at the time of the sale, the fact that there were also guilty ones would not prevent a recovery."

and under the allegations of the bill and the decision of the Supreme Court of Idaho hereinbefore cited, appellant must be regarded as an innocent member.

The case of Coit v. Gold Amalgamating Co., 119 U. S. 343, involved the question of fraudulent over-valuation. It was therein alleged that the property conveyed for stock was of no market or actual value. The Court says that if actual fraud were proved and plaintiff gave credit to the company from a belief that the stock was fully paid there would undoubtedly be substantial ground for the relief asked, and that

> "A gross and obvious over-valuation would be strong evidence of fraud."

The question did not arise on an objection to the sufficiency of the bill, but upon appeal after trial, and it appeared from the evidence not only that the valuation was in good faith, but that it was proper. No statute such as Section 4728 was involved.

In Northern Trust Co. v. Columbia Straw-Paper Company, 75 Fed. 936, it appears that the valuation was proper. All stockholders were fully advised of and acquiesced in the transaction and the action was against innocent third purchasers of the stock. The case was appealed to the Circuit Court of Appeals (80 Fed. 450) and on Writ of Certiorari to that Court went to the Supreme Court of the United States (Dickerman v. Northern Trust Co. 176 U. S. 181) which made a point of the fact that the transaction,

> "was not forbidden by the charter, or by any law or public policy."

In Clinton M. & M. Co. v. Jameson, 256 Fed. 577, it appeared that the valuation was proper and made in good faith; also that the stock sold was stock originally issued for full value and donated by the original holder to the corporation to sell as it pleased. No statute similar to Section 4728 was involved. The Court says of the matter of valuation:

> "Is always impeachable for fraud, and gross or intentional over-valuation is itself proof of fraud * * *. There is little if any distinction in the cases between actual fraud and fraudulent intent in over-valuation. * * *"
>
> "* * * We are concerned with their value to the corporation. * * *
>
> "* * * The question of value must be determined upon facts as they existed when the transaction was consummated, not by subsequent events. * * *"

The latter observation is valuable in this action since apparently this Court determines the value of the property transferred by long subsequent purchases of other stock.

Of O'Dea v. Hollywood Cemetery Assn., 97 Pac. 1, 6, it is sufficient to point out that the Court's holding that stock may be issued as fully paid up, though in fact less than par is paid, results from a lack of a statute in California similar to the Idaho statute in this case, which requires full payment upon stock issued as fully paid. It is to be noted that the California Court holds that calls may be made upon partially paid stock.

So in Inland Nursery & Floral Co. v. Rice, 57 Wash., 67, 106 Pac. 499, it does not appear that any such statute was involved, nor was there actual fraud in the valuation, which was not made, as in this case, exclusively by those who benefited by the valuation. Nor did any injury result to other stockholders, while in this action an attempt is being made to levy an assessment upon appellant's stock.

In conclusion we again direct the Court's attention to the fact that two transactions, separate and distinct and in some respects calling for the application of distinct principles and statutes are here involved. Even if it should be finally determined that no cause of action is stated, as to the matter of valuation of property exchanged for the stock first issued, though we firmly believe the facts and allegations are sufficient in that respect, yet there can be no question but that the subsequent sales of stock

were clearly contrary to the express statutory provisions, and that appellant is entitled, if the facts alleged be proved, to recover, for the corporation, the difference between the $25.00 per share paid in fact and the $100.00 par value credited thereon.

Respectfully submitted,

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Solicitors for Appellant.

I, SAM S. GRIFFIN, one of the counsel for the petitioner, do hereby certify that I have carefully read the foregoing petition for re-hearing, that in my judgment the same is well founded, and that it is not interposed for delay.

SAM S. GRIFFIN.

Service of the foregoing Petition for Re-hearing acknowledged this.....day of May, 1921.

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Solicitors for Appellee.